Cohesion MK Best Ideas

Investment Report

October 2024

Cohesion
Accessing India's Growth

India- just another GEM or a gem in its own right?

Cohesion MK Best Ideas continued to perform well during the most recent quarter, with **performance of 8.14% in USD terms and 2.24% in GBP**. This takes our **since-launch performance to 237.38% and 230.06%, respectively**. As the table below shows, that compares favourably with all major international equity markets, and local indices and peers.

USD (Data to 30.09.2024)	Performance (%) Since Inception 1st August 2020
Cohesion MK Best Ideas (USD)	**237.38**
Cohesion MK Best Ideas (GBP)	**230.06**
MSCI India*	93.58
S&P 500*	85.34
Nasdaq 100 *	85.88
Nifty 50*	79.61
MSCI All Country World Index (ACWI)*	65.14
MSCI Emerging Markets*	11.90
MSCI China*	-20.68

* iShares ETF, FE Analytics [Data 01.08.2020 – 30.09.2024], October 2024

Not all GEMS turn out to be precious

Investors like to place assets in buckets. When managing complicated portfolios in fast moving markets it can help to compartmentalise things. This allows asset allocators to get a snapshot of how much they have exposed to different asset types and regions. However, these shortcuts can bring problems. By lumping together countries into neat groupings such as Europe, Asia or Emerging Markets, it suggests that they are driven by similar factors. This is clearly not the case for all the countries of Europe or Asia and certainly not for Emerging Markets. When originally coined in 1981 by World Bank economist Antoine Van Agtmael, the term “Emerging Market” was a useful catch-all for investors.

Many of these markets were at the most embryonic stage of development. Their capital markets were still forming, research was almost non-existent, and governance was patchy at best. For international investors, it was very difficult to identify who would emerge as the winners and losers and therefore a sensible approach was to simply allocate part of a balanced portfolio to a single fund invested across a wide selection of Emerging Markets and be sure they would have at least some exposure to the ultimate gold medalists. In truth, the Emerging Market universe has never been a homogenous one. Various definitions of Emerging Markets today include countries such as South Korea, Mexico and Taiwan alongside Iran and Nigeria. An allocation to a basket of Emerging Markets is an allocation to some countries that are already very developed and also to countries that are arguably no more developed than they were in the 1980s.

Past performance is not indicative of future results.

Some investors still choose to invest in India via a broad Emerging Market fund. We think that this is a mistake for two reasons. Firstly, in our experience it is **rare for global emerging fund managers to have detailed on-the-ground knowledge of India**. They will usually arrange a few days of meetings with well-known companies when they are in Mumbai or Delhi but it may then be another year before they are back in India again. This makes it very difficult for them to be truly immersed in the currents that are driving the country. Secondly, we believe that India is now simply too big to be considered as just another emerging market. Whether looked at through the lens of population, GDP or stock market capitalisation, **India is a top-five country** and indeed more like its own continent. We are hearing of more investors who are actively allocating specifically to India and believe this is a sensible approach that will continue to accelerate.

India or China or both?

Inevitably, investors who are making specific allocations to India are also asking whether they should be doing the same with China. We can fully understand why they are asking this question with Chinese equities having performed so poorly over the last three years and appearing so cheap on a P/E basis. What's more, Chinese equities have been quite incredibly volatile. There have been plenty of opportunities to quickly make 25% in China (including this week as we wrote this newsletter) but also the chance to lose as much and more. So, do we think that a resurgence in interest in China might take some of the attention away from India?

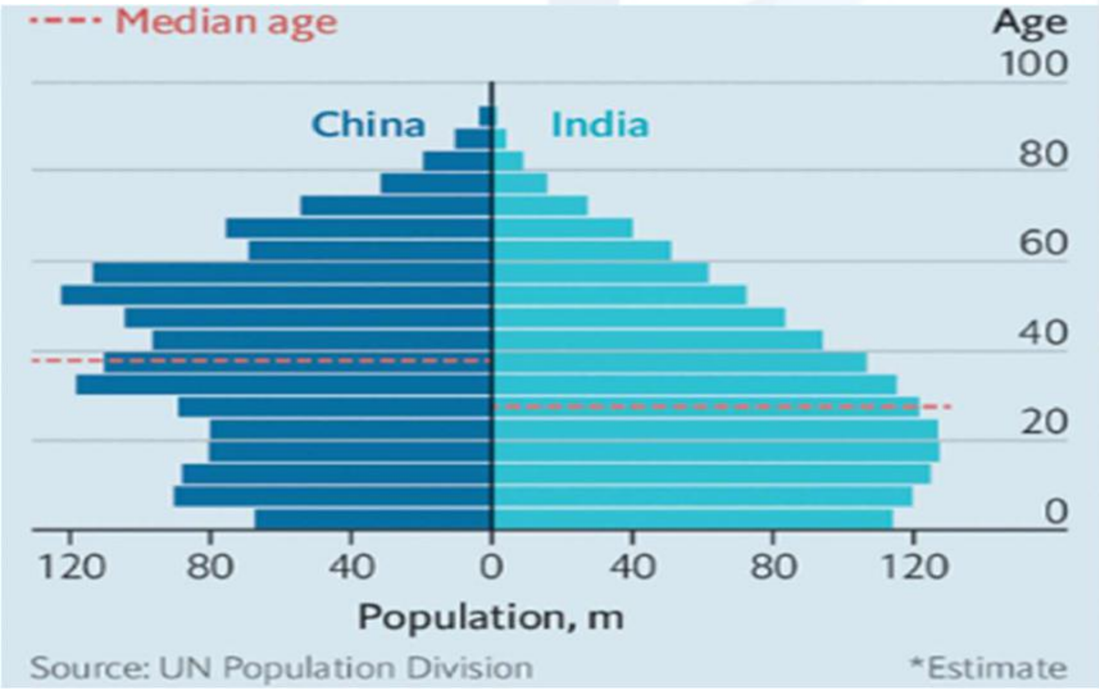
In short. No. For many institutional investors, China is simply off the agenda, regardless of how cheap it may be. At a Goldman Sachs conference in Hong Kong earlier this year, an astonishing 40% of delegates said that China was "uninvestable" at any price. Institutional investors have a myriad of opportunities around the world, and many do not have appetite for extreme political and governance risk when the outcome could be binary as it was in Russia. China is facing plenty of homegrown problems, most notably in property where the ripples of Evergrande have continued to spread far and wide. These problems may or not be fixable and each investor will have their own views as to whether they are willing to ride them out. However, it seems that a lot of investors are unwilling to take their chances that they will be able to correctly call a property recovery, only to see their investment wiped out by some political event. It isn't hard to think of how these political risks may unfold. The US is now unambiguously accusing China of supporting Russia in its war in Ukraine and Russia is reciprocating by providing China with highly sensitive military know-how. Then there is the often-repeated aim of reunifying Taiwan with 2027 being seen as a potential date for military action if peaceful means do not prevail. At the individual company level, trillions of dollars of combined market cap were wiped off the value of technology companies as Beijing chose to put the common good ahead of capitalism. These are just some of the risks that we know about.

Compare this with India. India is the world's largest democracy and has been one for seventy five years. It has the longest and most detailed constitution of any sovereign country on earth, with constitutional supremacy meaning that no parliament can override the constitution which was heavily based on British law.

Power in India is divided between executive, legislative and judicial branches, much as it is in the United States to provide important checks and balances. There is a free media across India which helps to hold policy makers to account. In addition, Indian stock markets are amongst the most strigently regulated in the world. Companies as small as $100m market cap will be using top 6 global auditors to audit their accounts. Ernst & Young has 80,000 people in India, Deloitte has 40,000. It is devilishly difficult to know how to reflect all of these things in a valuation. What premium do you attach to investing in a true democracy with well established rule of law in India compared with China?

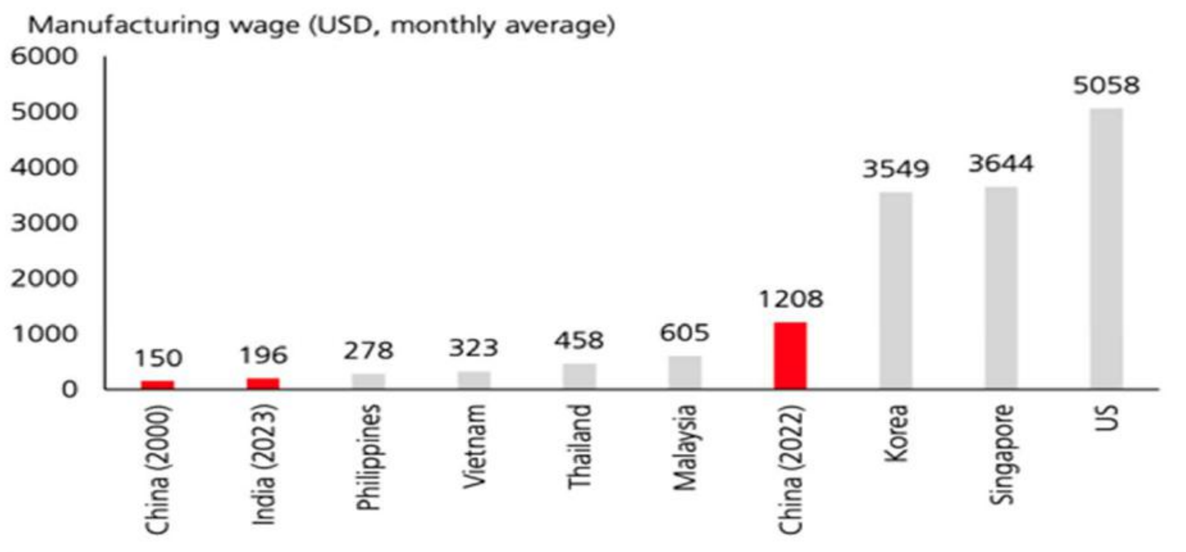
We are witnessing a similar story outside of stock markets. Across India we are regularly told of companies that are benefitting from “China +1” policies. International companies and government agencies are insisting on having reliable suppliers outside of China to avoid their supply chains being strangled if China does something unpredictable. They have suffered the consequences of being too reliant on China in the past and wish to significantly reduce their dependency for the future. India has deliberately remained neutral in the most sensitive areas of international politics and has seen this rewarded in being the partner of choice for many major international companies and governments. At the margin, **China +1 is acting as a headwind to China’s growth and a tailwind for India.** That leaves China increasingly dependent on domestically generated growth for its future. Again, **we can only see India as the winner**. China has been building infrastructure for decades. Its ports and bridges are already built. India still has decades of infrastructure spending yet to complete and **this will provide multiplier effects through the Indian economy**. Indian consumers are two decades behind Chinese consumers in purchasing all of the cars and domestic appliances that they will inevitably want.

It has long been recognised that demographics are hugely important in explaining and predicting economic growth. **Today, India’s demographic dividend gives it an edge on the rest of the world**. Twenty years ago, China could still claim to have a young population with a median age of around 29. Today that has increased to 39 whereas India, with a population size similar to that of China, has a median population age of just 28. It is worth remembering that much of China’s growth was fuelled by an abundance of cheap labour that was skilled enough to manufacture goods demanded in the West.



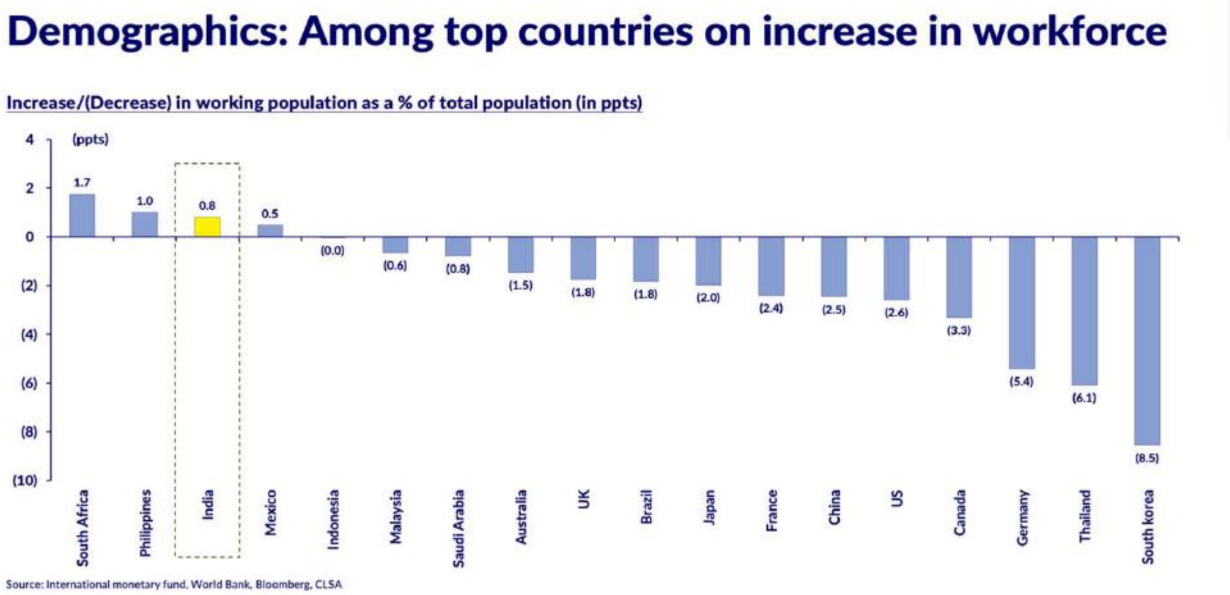
Today, a factory worker in China is likely to earn more than six times more than their equivalent in India, in part due to shortages created by China's one-child policy.

Average monthly manufacturing wages



Source: ILO, UBS; Note: Philippines, Malaysia, Korea, Singapore (2021); China, Vietnam, Thailand, and US (2022), India (2023). China wage in 2000 is 2022 equivalent, data is for urban non-private entities.

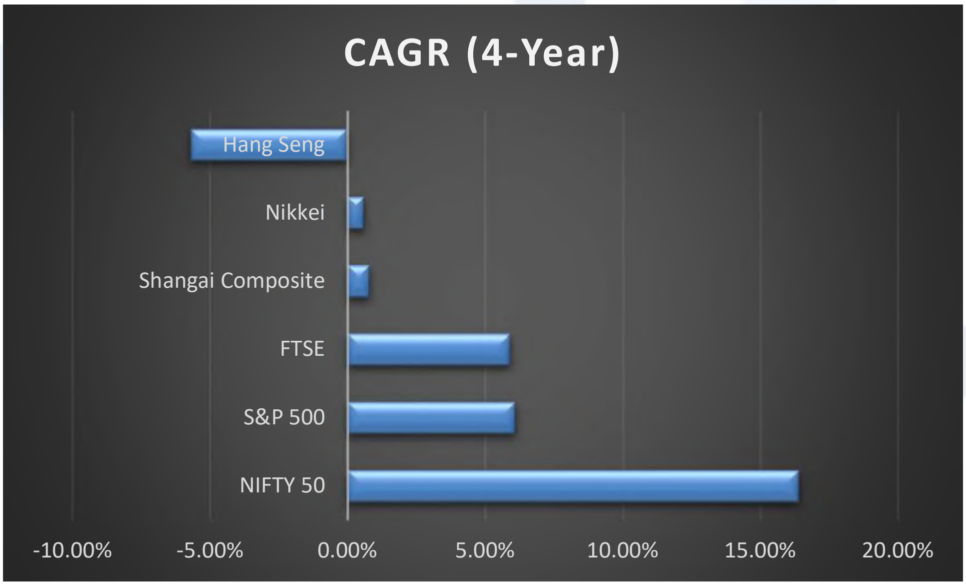
As the chart below demonstrates, India has the vast majority of its population of working age with their most productive years ahead of them and a lot of school age children yet to enter the workforce, whereas China's workforce is going to be greying much faster. Already China's old age dependency ratio has more than doubled from 10% to 22% since 2022 and is forecast to rise rapidly whereas India's still remains at 10%. Whilst this newsletter is devoted to comparing India with China, it is worth noting that shrinking work forces are a global issue. According to the IMF, less than a handful of major countries (if indeed South Africa, Philippines and Mexico can be considered major from an investing perspective) are seeing their working populations grow like India. All Western economies are seeing shrinking workforces with China suffering just as badly.



We also **much prefer the balance sheets of consumers, corporates and the government in India over those in China**. India and Indians maintained their fiscal discipline during Covid19, and this provides a lot more flexibility for the future. Contrast this with the Chinese government which demonstrated some of the worst largesse as it pursued a zero-Covid policy and then attempted to shore up the ailing property and financial sectors. Simultaneously, **India's foreign exchange reserves have seen a healthy improvement whilst China has markedly deteriorated**. Household debt as a proportion of GDP in India has barely changed over the last 20 years whilst in China, it is now at levels similar to those seen in most Western economies.

Lastly, when we look at just the raw valuations of Indian versus Chinese equities, even ignoring the appropriate risk premium, it is far from clear that Indian equities are overvalued. As we argued in the last newsletter, **a P/E ratio tells you nothing about value as it doesn't describe the growth you are forecast to get or the likelihood of receiving that. India boasts a far higher Return on Equity than China** and has demonstrated a rising ROE. **India's ROE has risen substantially over the last 5 years, far surpassing the pre-Covid19 levels whereas China's has fallen**. As the PEG ratio table below shows, **we are able to find plenty of companies that are trading on sensible P/E ratios but with far greater growth than is forecast in China** (or indeed other markets). What is more, we have a lot of confidence in the delivery of this growth. **Indian economic growth has been far more consistent than that of China and the growth of the country has translated into growth of company earnings which has in turn translated into strong stock market returns**. There will doubtless be companies that do well in China, barring any political fiasco, but we struggle to see why international investors will divert flows there when **India offers much more predictable growth**.

Earnings Growth (EPS) CAGR (4-Year)



Bloomberg

Portfolio activity

One97 Communications- the price is now right

Regular readers of our newsletters will be aware of how keenly we participate in the IPO market. We believe that it can provide wonderful opportunities with the potential to make money quickly. We have successfully participated in several since the launch of Cohesion MK Best Ideas and have seen returns of 50%+ in a few short months. The challenge for some investors has been securing meaningful allocations in the most attractive IPOs but our access has allowed to us participate when others were unsuccessful in their applications. However, it would be a mistake to believe that all IPOs do well. There have been many that were overhyped and listed at a price that offered little upside. Sadly, these tend to be those with the greatest retail participation, and it is not uncommon to see small investors panicking out of IPOs that aren't delivering the expected short-term profits.

We never forget that it is possible to have good companies with bad share prices and vice versa, especially in the short term. We regularly meet the management of IPO companies, even if we believe that the price is unrealistic. We will then keep a close eye on their progress and if the market gives us the chance to pick up stock at attractive levels once the new issue fever has passed, we may do so.

One97 Communications is one of India's biggest digital payments companies, also offering digital advertising and a variety of related services. Through its **Paytm** brand, it is used by some 30m customers and 8m merchants each month. When the company announced its intention to IPO in the summer of 2021, it was hailed as India's largest ever IPO. We were unable to see value in the IPO price and declined to invest. Plenty of other investors did so and suffered savage losses. From its issue price, the share price fell around 85%, bottoming earlier this year. The company's founder Vijay Shekhar Sharma has gone on record saying that "We didn't choose the right bankers!" to help with the listing. The company has gone through a period of considerable self help over the last three years as well as tidying up the shareholder register. We continue to believe that the business is an excellent one and the reasons for people being so excited about its prospects are intact. The Indian digital transactions market has already grown to circa $3tn per annum and this is forecast to more than double again over the next four years when individual transaction numbers are expected to be approaching 500bn every year. Paytm is an excellent platform and we have very high regard for the company's management. The company has recently announced that it is selling its online gaming business for an attractive valuation and this might herald the start of other non-core divestments that may generate cash and allow them to focus on the high growth core financial products. There can be little doubt that India will continue to rapidly embrace digital payments, **it already accounts for almost half of all global real time payment transactions**, and Paytm is ideally placed to benefit from this. One97 Communications always had the potential to be a great investment at the right price. We believe that the price is right.

Nazara Technologies- a unique play on online gaming

Remarkably, Nazara Technologies is India's only listed online gaming business. India is a massive country with a young and increasingly affluent population that is happy to spend money having fun. Nazara offers a wide range of games, mostly based on "eco-spheres" in which large numbers of like-minded gamers can play together.

Some of these games are aimed at the very young and are education focused but they are also the leading company in ultra-competitive esports that are as keenly contested as most physical sporting events. What's more, they offer World Cricket Championship, a game downloaded more than 200 million times; hardly surprising in cricket-mad India. They also host Sportskeeda, India's largest sports website.

Nazara is a highly acquisitive company. With an excellent shareholder base that has been supportive of their strategy, Nazara has been able to buy nine complementary businesses in the last six month alone. Nazara, with their broader platform, should be able to far better monetise these assets. In particular, through Nazara's control of Datawkrz, the digital advertising company, they have scope to reach out to a greater number of advertisers and also cross-sell their platforms. Even without these acquisitions, Nazara looks set for solid revenue and profit growth over the next few years, but we anticipate further inorganic growth to supplement this.

Looking ahead

In previous newsletters we have commented that the Indian market doesn't look cheap, nor does it look especially expensive. India seldom looks cheap for very long because there are plenty of investors who recognise the unrivalled trends driving the country and they are only too happy to accumulate Indian equities if they temporarily become undervalued.

We continue to find a far greater number of attractive shares than we need to populate a Best Ideas portfolio and look forward with confidence on any medium-term view. We have built a portfolio that is demonstrably **cheaper than the market** and yet offers **superior earnings growth**, greater visibility of growth, and plenty of catalysts for this value to be realised. This is summarised neatly in the PEG ratios which show the very **attractive asymmetry of our portfolio** versus both India and the world's largest market – the US.

	PE Valuation		Earnings Growth (%)	PEG Ratio
	10YR PE	FY26E PE	FY26E	FY26E
Cohesion MK Best Ideas	**-**	**18.5**	**41.5**	**0.45**
Nifty 50	23.4	20.9	14.3	1.46
MSCI India	24.8	23.8	16.7	1.43
MSCI India Small Cap	34.4	25.7	23.9	1.07
S&P 500	21.3	21.1	15.3	1.38

Invexa Capital and Bloomberg, September 2024

Strategy Performance: Data as at 30th September (Q3) 2024

Discrete Performance** (%)							
		Q1	Q2	Q3	Q4	YTD	Since Launch: Aug 2020*
USD	2024	14.49	18.08	8.14		46.21	237.38
	2023	-7.06	19.14	12.60	14.78	43.12	130.75
	2022	-2.22	-13.25	13.45	2.18	-1.68	61.23
	2021	11.31	11.01	13.13	1.58	42.00	63.98
	2020	-	-	-0.19	15.70	15.48*	15.48
		Q1	Q2	Q3	Q4	YTD	Since Launch: Aug 2020*
GBP	2024	15.47	17.89	2.24		39.17	230.06
	2023	-8.98	15.71	17.25	9.99	35.83	137.17
	2022	0.71	-6.41	23.69	-5.54	10.12	74.60
	2021	10.40	10.63	16.12	1.15	43.45	58.56
	2020	-	-	1.08	9.35	10.54*	10.54

*August 1st 2020
**net of taxes and fees, gross of performance fees

*Cash deployed cautiously during COVID-19 outbreak and 90% deployment reached by end of February 2021

	Equity	Cash
1st 6 months	45%	55%
1st 12 months	68%	32%
Since Inception	84%	16%

Portfolio – 30th September 2024

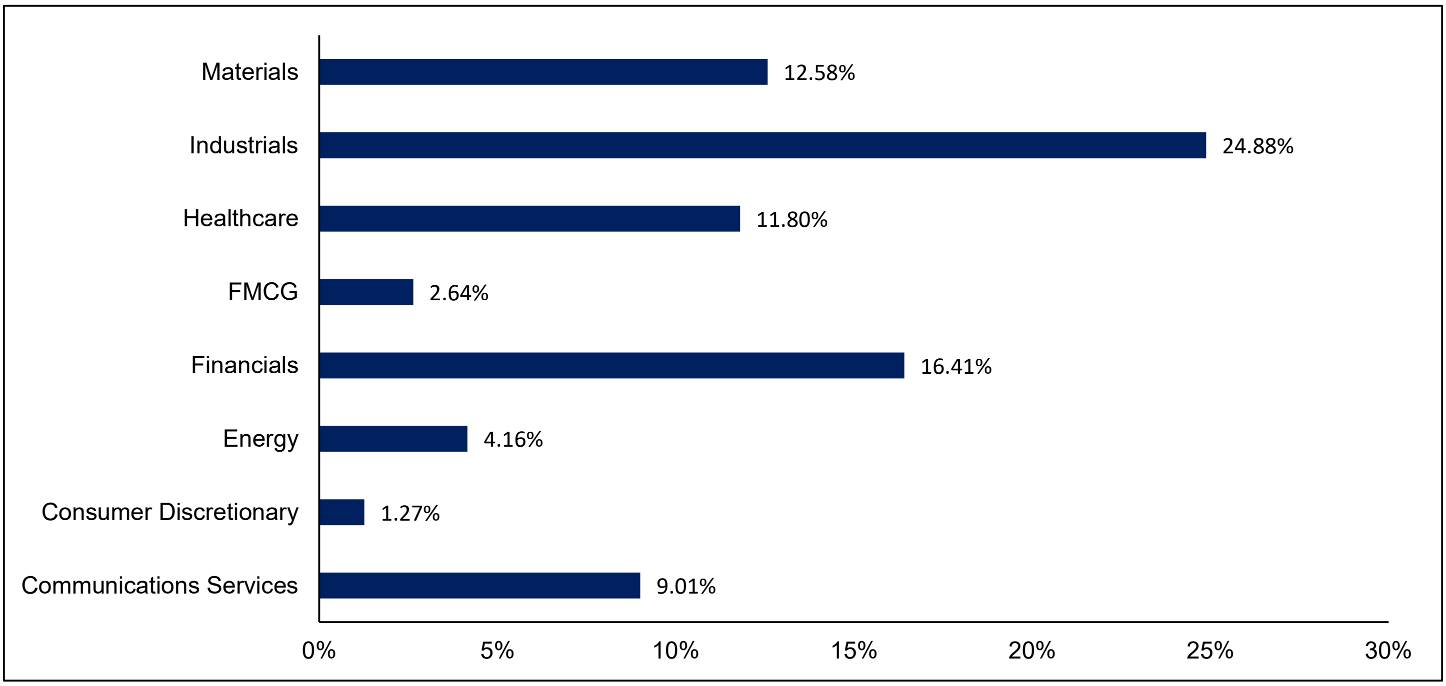
Top 5 Holdings

Security Name	% Holding of Portfolio
Shilpa Medicare Limited	6.31%
Vedanta Limited	4.96%
Dynamatic Technologies Limited	4.46%
Transformers and Rectifiers Limited	4.34%
Lloyds Metals and Energy Limited (WARRANTS)	4.25%

Past performance is not indicative of future results.

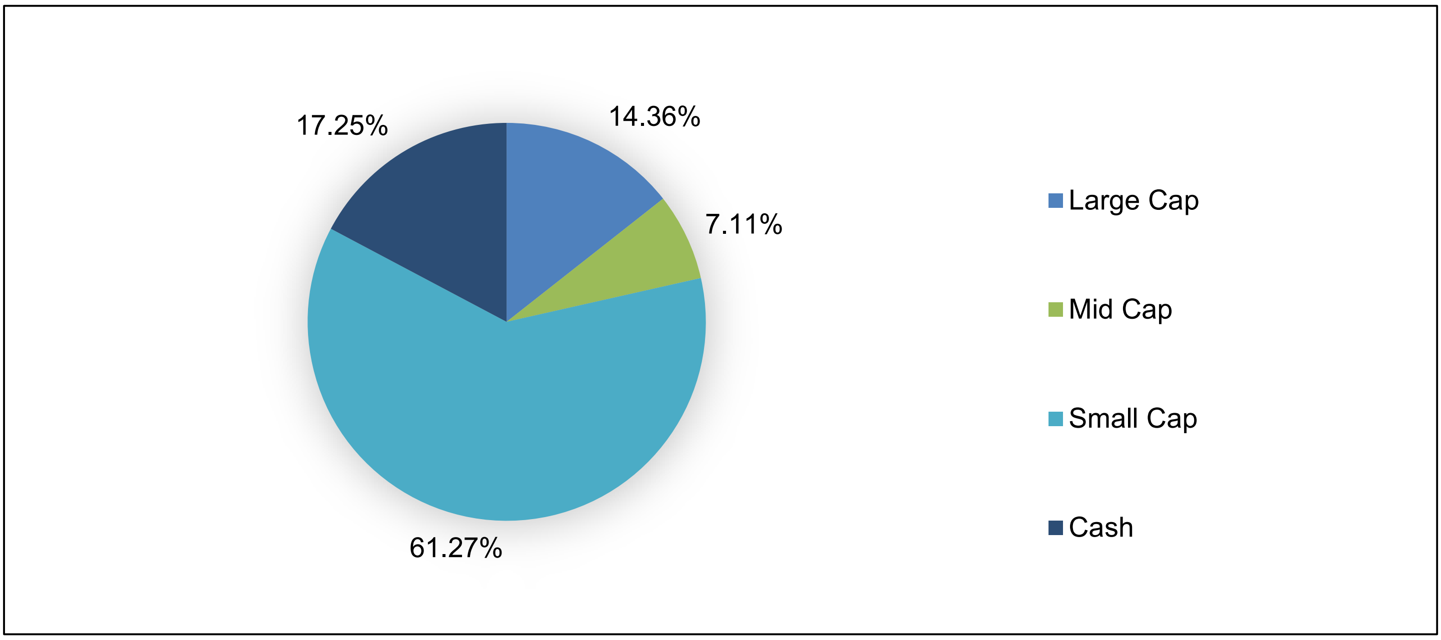
Portfolio – 30th September 2024

Sector Exposure



Portfolio allocations may not add to 100% due to rounding and cash holding

Market Cap Exposure



SEBI market cap breakdown – **Large Cap**: top 100 largest companies ranked by market cap,
Mid Cap: 101-250 companies ranked by market cap, **Small Cap**: companies ranked 251 and onwards

Past performance is not indicative of future results.

For further information:

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